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In the Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY, ET AL.,
PETITIONERS

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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16 pp

QUESTION PRESENTED

Whether the refusal of respondent, a state public utility commission, to allow one of the petitioners to recover costs incurred pursuant to a contract for the purchase of natural gas from an affiliated company, violated the "filed rate doctrine" because the purchase contract had been approved by the Federal Energy Regulatory Commission and respondent's determination that less expensive sources of gas were available did not adequately consider the legal significance of the contract's minimum bill provision.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	2
Statement	2
Argument	7
Conclusion	13

TABLE OF AUTHORITIES

Cases:

Burford v. *Sun Oil Co.*, 319 U.S. 315 (1943)	5
FERC Order No. 380, 49 Fed. Reg. 22778 (1984), aff'd *sub nom. Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986)	10
Kentucky West Virginia Gas Co., 43 F.E.R.C. ¶ 61,496 (1988)	10
Kentucky West Virginia Gas Co., 33 F.E.R.C. ¶ 61,240 (1985)	12
Mississippi Power & Light Co. v. *Mississippi*, No. 86-1970 (June 24, 1988)	7, 8, 11
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986)	5, 6, 8
Pike County Light & Power Co. v. *Pennsylvania Public Utility Comm'n*, 77 Pa. Comw. 258, 465 A.2d 735 (1983)	4
PUC v. *Equitable Gas Co.*, No. R-880932 (Sept. 1, 1988)	12
PUC v. *Equitable Gas Co.*, 87 P.U.R.4th 131 (1987)	12
Texas Eastern Transmission Corp., 43 F.E.R.C. ¶ 61,076 (1988)	10-11
Younger v. *Harris*, 401 U.S. 37 (1971)	5

Statutes:

Natural Gas Act, 15 U.S.C. 717 *et seq.*	2
15 U.S.C. 717c(a)	2
15 U.S.C. 717(c)(c)	2
Pa. Cons. Stat. Ann. § 1318(a) (Purdon Supp. 1988)	3

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-40a) is reported at 837 F.2d 600. The prior opinion of the court of appeals (Pet. App. 80a-95a) is reported at 791 F.2d 1111. The opinion of the district court (Pet. App. 41a-79a) is reported at 650 F. Supp. 659. The prior opinion of the district court (Pet. App. 96a-104a) is reported at 620 F. Supp.

1458. The order of the Pennsylvania Public Utility Commission (Pet. App. 107a-163a) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 105a) was entered on January 19, 1988, and a petition for rehearing was denied on February 16, 1988 (Pet. App. 106a). Pursuant to orders issued by Justice Brennan, the time within which to file a petition for a writ of certiorari was extended to and including July 15, 1988, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Pursuant to the Natural Gas Act, 15 U.S.C. 717 *et seq.*, the Federal Energy Regulatory Commission (FERC) is responsible for ensuring that all rates and charges of natural gas companies for or in connection with the transportation or sale of natural gas in interstate commerce are "just and reasonable" (15 U.S.C. 717c(a)). Natural gas companies are required to file with FERC schedules setting forth all rates and charges for any transportation or sale within FERC's jurisdiction (15 U.S.C. 717c(c)).

Petitioner Kentucky West Virginia Gas Company (Kentucky West), an interstate pipeline, is one of three principal suppliers of natural gas to its affiliate Equitable Gas Company (Equitable), a company engaged in retail distribution of natural gas to consumers in Pennsylvania and in other states (Pet. App. 3a-4a). FERC has approved the terms of the contract entered into between Equitable and Kentucky West (*id.* at 4a), including both the rates at which Equitable purchases the natural gas and a "minimum

commodity bill" provision, which requires Equitable "to pay the full commodity charge for [the] minimum volume of gas regardless of whether Equitable actually needs or wants the gas" (*id.* at 45a (footnote omitted)). The contract also includes a *force majeure* clause, which Equitable invoked on June 30, 1983, when it reduced its purchases effective July 1, 1983, to volumes below minimum bill levels and informed suppliers, including Kentucky West, that Equitable would pay only for gas taken (*id.* at 148a).

In March 1985, Equitable filed a request with respondent, the Pennsylvania Public Utility Commission (PUC), for a rate increase to recover the amount by which its actual costs had exceeded its revenues during the period from July 1983 through December 1984 (Pet. App. 109a, 132a-143a). The PUC granted Equitable's request for a rate increase, but adjusted downward the level of the increase (*id.* at 142a-143a, 162a). The PUC's adjustment denied Equitable the right to recover approximately $14.3 million in previously-incurred costs (*id.* at 46a).

The PUC cited as authority for its decision both its inherent authority to disallow the pass-through of imprudently incurred costs (Pet. App. 134a), and a recently-enacted state statute barring the PUC's approval of a proposed tariff in the absence of a showing that "the utility is pursuing a least cost fuel procurement policy, consistent with the utility's obligation to provide safe, adequate and reliable service to its customers" (Pa. Cons. Stat. Ann. § 1318(a) (Purdon Supp. 1988); see Pet. App. 4a-5a n.1). The PUC explained that it agreed with the Office of Consumer Advocate and the PUC's Trial Staff that Equitable should not be entitled to recover all of its excess

costs during the relevant period because it had purchased gas from Kentucky West at a price substantially higher than that available from other sources of gas (Pet. App. 142a-143a). The PUC rejected Equitable's claim that its purchases from Kentucky West were justified because it needed "to reduce the quantity of excess gas supply on its system," or alternatively, because "any gas not taken from a pipeline supplier is lost to Equitable" (*id.* at 137a-138a; see *id.* at 139a-140a). The PUC also rejected Equitable's argument that "its production takes resulted in lower net costs given its minimum commodity bill liability from its pipeline suppliers" (*id.* at 140a). The PUC described how the Office of the Consumer Advocate had "point[ed] out that Equitable has never demonstrated on this record that the shutting-in of local production and local purchases of gas was cost justified in relation to the minimum commodity bill liability which it would have incurred had it continued to take local production and local purchases of gas supply while cutting back on its pipeline takes" (*ibid.*).

Finally, the PUC rejected Equitable's contention that FERC's approval of its contract with Kentucky West preempted any authority on the part of the PUC to deny Equitable complete recovery of its costs (Pet. App. 143a-145a). Relying on *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Comm'n*, 77 Pa. Comw. 268, 274-275, 465 A.2d 735, 738 (1983), the PUC concluded that it could "examine Equitable's purchased gas costs incurred and deny the collection of any excessive affiliated costs incurred in light of other available alternatives," without taking any action inconsistent with FERC's determination of the justness and reasonableness of the contract (Pet. App. 145a).

2. The district court upheld the PUC's determination (Pet. App. 41a-79a).[1] The court rejected petitioners' claim that a contrary result was compelled by *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), in which this Court held that state regulatory authorities may not establish retail rates for electric power based upon an allocation of low-cost hydroelectric power different from that established by FERC (Pet. App. 53a-54a). According to the district court, in this case, unlike in *Nantahala*, "[n]o single entity, simultaneously serving as wholesaler and retailer, is subject to the potential of conflicting orders from federal and state agencies. There is accordingly no risk of 'trapped costs' and the filed rate doctrine is inapplicable here." Pet. App. 53a. Moreover, the district court further explained, in *Nantahala* the Court had explicitly assumed that "a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive" where "lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable *price*" (Pet. App. 54a (quoting 476 U.S. at 972 (emphasis in original)); see also Pet. App. 63a).[2]

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[1] The district court initially dismissed the complaint on the ground that abstention was appropriate under *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943) and *Younger* v. *Harris*, 401 U.S. 37 (1971) (see Pet. App. 96a-104a), but the court of appeals reversed and ordered the district court to consider the case on the merits (see *id.* at 80a-95a).

[2] The district court also rejected petitioners' Commerce Clause and equal protection claims (see Pet. App. 64a-75a, 75a-78a). The court declined to rule on petitioners' due process claim (see *id.* at 69a n.14).

3. The court of appeals affirmed (Pet. App. 1a-40a). The court agreed with the district court that *Nantahala* "in no way undermines the long-standing notion that a state commission may legitimately inquire into whether the retailer prudently chose to pay the FERC-approved wholesale rate of one source, as opposed to the lower rate of another source" (Pet. App. 17a). The court also found no conflict between FERC's authority and that exercised by the PUC in this case because "the question here of whether the retailer acted with economic prudence in purchasing from one wholesaler rather than another is never before FERC" (*id.* at 18a).

The court of appeals likewise rejected petitioners' claim that the PUC's $14.3 million disallowance was impermissible because that amount "represented fixed and unavoidable costs incurred by the company * * * pursuant to its minimum bill contractual obligation with Kentucky West" (Pet. App. 18a-19a (footnote omitted)). The court agreed with Equitable that it was probably beyond the power of the PUC to decide "that Equitable should not have purchased gas from Kentucky West in favor of less expensive supplies without regard to the fact that Equitable would have had to pay for the gas in any event under the minimum bill contract" (*id.* at 19a). Nonetheless, after "a time-consuming analysis of the proceedings below," the court of appeals "conclude[d] that Equitable failed to provide an analytic framework supporting an argument that the $14.3 million disallowance represented an unavoidable FERC-approved contractual obligation. The record simply does not demonstrate that any portion of the disallowed costs represented Equitable's minimum bill obligation." *Id.* at 21a. The court also explained that Equitable's in-

vocation of the *force majeure* clause on June 30, 1983, created "uncertainty as to what minimum bill costs, if any, would *ever* be incurred by Equitable" and thus further "justified the PUC's refusal to consider minimum bill liability in evaluating whether Equitable had pursued a least cost fuel procurement policy for the twelve month period under examination" (*ibid.* (emphasis in original)).[3]

ARGUMENT

Petitioners' disagreement with the court of appeals' ruling, whatever its merit, concerns a narrow and essentially factbound matter that does not warrant plenary review by this Court.[4] Nor does this Court's intervening decision in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), add anything sufficiently new to the legal principles applied by the court of appeals to warrant this Court's

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[3] Like the distirct court (see note 2, *supra*), the court of appeals rejected petitioners other claims for relief, including their contentions that the PUC had violated the Commerce Clause, and had deprived Equitable of its due process, "right to counsel," and discovery rights (see Pet. App. 23a-33a, 33a-36a, 36a-39a, 39a-40a).

[4] Although FERC is nominally a party in this case, it did not actively participate in the district court and participated only in a limited fashion in the court of appeals (see Pet. App. 8a n.4 ("The Federal Energy Regulatory Commission is a named defendant, but their position is more akin to that of an amicus."). FERC there addressed petitioners' preemption theory in general terms, without taking a formal position on the minimum bill issue (see Pet. 16-17 n.14). Because FERC did not address petitioners' takings or due process arguments in the court of appeals, we address here only the question whether petitioners' preemption claim warrants further review.

granting the petition for the limited purpose of vacating the judgment and remanding the case for reconsideration in light of that decision. The petition therefore should be denied.

1. The scope of petitioners' dispute with the court of appeals' decision is extremely narrow. For their part, petitioners must acknowledge in light of this Court's decisions in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 972 (1986), and more recently in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), slip op. 18-19, that "it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy the power" (*Mississippi Power & Light Co.* v. *Mississippi*, slip op. 19). The court of appeals, on the other hand, does not question that the PUC's authority to disallow Equitable's costs on prudence grounds is limited by Equitable's obligation under the minimum bill provision to pay for a certain amount of Kentucky West's gas regardless of Equitable's actual purchases. Moreover, petitioners do not challenge the lower courts' determination that the PUC did not deny Equitable its right to recover minimum bill costs that it had actually incurred for gas not purchased from Kentucky West. The only matter truly in dispute before this Court is whether Equitable provided a sufficient "analytic framework" to support its claim that its decision to purchase gas from Kentucky West rather than from seemingly less expensive alternative sources was prudent because of the minimum bill costs Equitable *would have incurred* had it bought from those other sources (see Pet. 16-17; Pet. App. 21a).

a. The court of appeals held in part that petitioners failed to make an adequate evidentiary showing because they had not quantified their minimum bill obligation (Pet. App. 22a). In particular, the court explained, "[n]o mathematical figures were presented establishing what actual costs Equitable * * * would incur due to its minimum bill liability to Kentucky West, if it had purchased the gas from other suppliers in conformity with the PUC Order" (*ibid.*).

To the extent the court of appeals relied on Equitable's failure to quantify further its minimal bill obligation, we agree with petitioners that [reasoning] may be flawed. Because Equitable's purchases from Kentucky West during the relevant period were either at or below the minimum amount established by the minimum bill provision, those purchases were necessarily prudent *if the minimum bill provision was legally effective*; the cost to Equitable of purchasing that gas from other sources would have been the price charged by those other sources *plus* Equitable's minimum bill payments. Any other conclusion by the PUC would have ignored the import of the FERC-approved tariff, including the minimum bill provision, and hence violated the filed rate doctrine.[5]

b. In addition, however, the court of appeals also questioned the legal status of the minimum bill provision at the time that Equitable incurred the costs for which it sought recovery from the PUC. In this regard, the court of appeals concluded that the PUC

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[5] We therefore disagree with the PUC's intimation that the minimum bill obligation is not relevant to the prudence of Equitable's decision to purchase gas from Kentucky West, but rather only "increases a buyer's cost for quantities of gas *not taken*" (Br. in Opp. 6 n.4 (emphasis in original)).

was justified in refusing to consider Equitable's minimum bill liability because of the uncertain status of the minimum bill provision of the contract following Equitable's invocation of the *force majeure* clause (Pet. App. 21a). Petitioners' principal response (Pet. 15 nn. 12, 13) is that this conclusion of the court of appeals is mistaken because Equitable invoked *force majeure* only for the gas not needed and therefore did not intend to disturb its minimum obligation for gas it actually needed and did purchase.

The impact of Equitable's invocation of the *force majeure* clause on the minimum bill provision presents a question that is not well developed by the record. We have not duplicated the court of appeals' "time-consuming analysis of the proceedings below" (Pet. App. 21a) and at this stage of the case are not inclined to second guess the court of appeals' assessment of the record, particularly in light of the limited nature of FERC's participation in those proceedings (see note 4, *supra*). But, whatever the merits of the dispute about the significance of Equitable's invocation of the *force majeure* clause, we do not believe that this Court's review of the factbound issue is warranted.

In addition, although substantial sums of money are at stake in this case, the issue is unlikely to recur in the future. FERC has decided to eliminate minimum bill provisions from many pipelines tariffs, including Kentucky West's tariff, based on their anticompetitive effects. See, *e.g.*, FERC Order No. 380, 49 Fed. Reg. 22778 (1984), aff'd *sub nom. Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986); *Kentucky West Virginia Gas Co.*, 43 F.E.R.C. ¶ 61,496 (1988); *Texas Eastern Transmission Corp.*, 43 F.E.R.C. ¶ 61,076

(1988); see Pet. App. 69a-71a. Contrary to the claims of petitioners and their supporting amici, therefore, the court of appeals' ruling does not announce a rule of law of major practical import that risks creation of "considerable confusion regarding the application of previously-settled federal principles" (Pet. 19-20).

2. Like respondent PUC (Br. in Opp. 12-15), we also do not believe that further review is warranted on account of this Court's intervening decision in *Mississippi Power & Light Co.* v. *Mississippi*, *supra* (see Pet. 18-20). As petitioners acknowledge (Pet. 10), that decision simply "reaffirmed" the basic principle first set forth in *Nantahala* that a state may not treat as unreasonable or imprudent costs mandated by a FERC-approved contract (see *Mississippi Power & Light Co.* v. *Mississippi*, slip op. 18-19)). *Mississippi Power & Light* provides no particular guidance beyond that earlier provided in *Nantahala* on the question raised here, which is fairly confined to the significance of a utility's invocation of a *force majeure* clause on its minimum bill obligations. A remand for further consideration in light of this Court's decision in *Mississippi Power & Light* is therefore not required.

3. Finally, further review is not warranted because petitioners' concerns can be fully and more appropriately addressed in other proceedings. As described above, the court of appeals concluded that the PUC was justified in ignoring the minimum bill provision because of the uncertain legal status of that provision at the time Equitable incurred the costs for which it is now seeking recovery. Equitable and Kentucky West, however, have since entered into a settlement agreement (see Pet. App. 148a-149a) concern-

ing Equitable's minimum bill obligations. That agreement, which was approved by FERC shortly before petitioners filed their complaint in district court in this case, provides for reductions in Equitable's minimum bill obligation for the period July 1983 through July 1984. See *Kentucky West Virginia Gas Co.*, 33 F.E.R.C. ¶ 61,240 (1985). Hence, the extent of Equitable's minimum bill obligation during the relevant time period should no longer be uncertain and petitioners' request for recovery should be subject to reconsideration by the PUC.

Indeed, that is precisely what has happened. The PUC has since permitted Equitable to pass through in its retail rates the settlement amount that reflects the "fixed cost" component of the minimum bill obligation (approximately $2.5 million), which is part of the $14.3 million being sought in this litigation. See *PUC* v. *Equitable Gas Co.*, 87 P.U.R.4th 131, 136-139 (1987); PUC Br. in Opp. 4-5. In addition, although the PUC has more recently denied Equitable the right to recover an additional $10.2 million that Equitable claims reflects its minimum bill obligations under the settlement agreement for that period (see *PUC* v. *Equitable Gas Co.*, No. R-880932 (Sept. 1, 1988), slip op. 5-13; PUC Br. in Opp. 5 n.3), that development is not a reason for further review in this case. Instead, to the extent that the PUC's latest action may be inconsistent with the filed rate doctrine, because it fails to consider Equitable's minimum bill obligation in determining the prudence of its purchases, petitioners should challenge the PUC's adverse determination directly.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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* The Solicitor General is disqualified in this case.

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